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FISCAL IMPACT STATEMENT

LS 6604 **NOTE PREPARED:** Mar 15, 2013
BILL NUMBER: SB 244 **BILL AMENDED:** Mar 14, 2013

SUBJECT: Hoosier Business Investment Income Tax Credit.

FIRST AUTHOR: Sen. Wyss **BILL STATUS:** CR Adopted - 2nd House
FIRST SPONSOR: Rep. Thompson

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State
DEDICATED
FEDERAL

Summary of Legislation: (Amended) The bill contains the following provisions:

Hoosier Business Investment Tax Credit (HBI): It adds logistics investments as a specific type of qualified investment under HBI. The bill specifies in detail the expenditures that qualify as a logistics investment. It requires the Indiana Economic Development Corporation (IEDC) to find that an applicant's logistics investment project will enhance the logistics industry by creating new jobs, preserving existing jobs that otherwise would be lost, increasing wages in Indiana, or improving the overall Indiana economy in order to approve the applicant's project for a tax credit. It makes conforming changes to the credit application and agreement provisions.

The bill provides that the percentage credit maximum is 25% (instead of 10%) if a qualified investment is a logistics investment. It provides that for logistics investments, the qualified investments used to determine the credit are based on growth in qualified investments by the taxpayer using 105% of the investments made by the taxpayer during the immediately preceding two years. It adds a $50 M state fiscal year ceiling for tax credits that are based on nonlogistics investments and establishes a $10 M state fiscal year ceiling for tax credits that are based on logistics investments.

The bill also requires the Department of State Revenue (DOR) to annually report to the Budget Committee on the use of the tax credit for logistics investments.

Rural Entrepreneurship Area Development Incentives (READI): The bill permits the Office of Community and Rural Affairs (OCRA) to designate an applicant rural county as a READI area. It provides for the distribution of adjusted gross income taxes annually paid by employees working in an area for a new business or annually paid by additional employees in an existing business and by the new business itself to the rural county for the development of new business opportunities in the rural county, including transfers to local or regional venture capital funds. It limits the amount that may be distributed to a particular county in any year to $250,000. The bill requires a matching local grant from County Economic Development Income Tax (CEDIT) funds to qualify for a distribution. The bill limits the number of counties that may receive funds for a rural entrepreneurship area development territory to 30. It appropriates money collected from counties with a rural entrepreneurship area development territory for distribution to those counties.

Effective Date: (Amended) Upon passage; January 1, 2014.

Explanation of State Expenditures: (Revised) *Department of State Revenue (DOR):* The DOR will incur additional expenses to revise tax forms and instructions and update computer programs to reflect the modifications to the HBI credit and to compute the READI distribution to each participating county. The DOR's current level of resources should be sufficient to implement the provisions within the bill.

Indiana Economic Development Corporation (IEDC): The IEDC will incur additional expenses to revise applications and upgrade evaluation procedures. The IEDC's current level of resources should be sufficient to implement the modifications within the bill.

(Revised) *Office of Community and Rural Affairs (OCRA)*: The bill requires the OCRA to administer the READI program. They will evaluate applications, determine whether county businesses are new or existing, and oversee other aspects of the program. They may begin establishing READI areas upon passage of the bill. The OCRA's current level of resources should be sufficient to implement this program.

Explanation of State Revenues: (Revised) *Summary* - This bill may reduce revenue deposited in the state General Fund by $2.5 M in FY 2014 and $12.5 M in FY 2015.

(1) The changes to the HBI tax credit may reduce state revenue by $10 M a year beginning in FY 2015.

(2) The maximum potential revenue capture in READI areas from full program participation is $7.5 M per fiscal year. However, full participation is not expected in the first few years of the program. It is more likely that the READI areas may capture about $2.5 M beginning in FY 2014. The cost of the READI program will increase as more counties participate.

Hoosier Business Investment Tax Credit (HBI): This bill makes changes to the HBI tax credit. It defines a new award criterion for logistics investments, establishes a new credit award tier for logistics investments, and specifies that the current credit award computation applies to nonlogistics investments. The changes are effective for taxable years beginning January 1, 2014. The revenue loss from these changes will likely begin in FY 2015, but could begin in FY 2014 if taxpayers change their quarterly estimated payments in the first half of CY 2014. The revenue loss to the state General Fund due to the bill is estimated to be $10 M per year beginning in FY 2015. This revenue loss would be attributable to HBI credits for qualified logistics investments.

(Revised) *Rural Entrepreneurship Area Development Incentives (READI)*: This bill allows the OCRA to designate rural counties as READI areas. Once a READI area is established, it will receive an annual distribution based on the state income tax revenue collected from new employees and new businesses minus any EDGE credits awarded and the incremental income tax paid by existing businesses that expand operations without receiving any state incentives.

A precise revenue estimate is indeterminable. The reduction in revenue depends on the number of READI areas established and the economic activity within the area. The bill caps the amount of taxes distributed to a single county to $250,000 a year and only 30 counties may be designated as a READI. The maximum potential revenue loss from full program participation is $7.5 M per fiscal year. However, it is unlikely 30 counties will participate in the program in the first few years. It is more likely that 10 counties may be designated as READI areas by FY 2014. The maximum revenue captured by 10 READI areas would be $2.5 M.

The net revenue impact of diverting the incremental income tax revenue to the READI areas depends on the extent that additional tax collections beside the incremental income tax revenue are generated from economic activity induced by the READI area. However, if the economic activity investment would have occurred in the absence of the READI area, the state would incur a revenue loss equal to the total amount of income tax collections diverted to the READI area.

Additional Information - Hoosier Business Investment Tax Credit (HBI): Under current statute, the HBI credit equals up to 10% of the qualified investments made during the taxable year. The credit percentage is determined by the IEDC. Under the bill, the HBI credit would be computed differently for nonlogistics and logistics investments. The credit allowed under current statute would, under the bill, apply to nonlogistics investments. For logistics investments, the bill would allow the IEDC to grant a credit of up to 25% of the qualified logistics investments made during the taxable year. However, the amount of qualified logistics investments used to determine the credit is derived by taking the difference of the qualified logistics investments made in the current year and 105% of the average annual qualified logistics investments made in the prior two years. Under the bill, the total amount of HBI credits granted specifically for logistics investments is limited to $10 M per fiscal year and $50 M per fiscal year for nonlogistics investments.

The bill provides that projects involving logistics investments should be evaluated using a different criterion than nonlogistics investments when determining whether the credit should be awarded. Under the bill, a nonlogistics investment must directly result in job creation, job retention, or increased wages in order for the IEDC to enter into a tax credit agreement with the applicant. A logistics investment will be evaluated based on how the project will enhance the logistics industry by creating new jobs, preserving existing jobs that otherwise would be lost, increasing wages in Indiana, or improving the overall Indiana economy.

The credit can be used to offset tax liabilities from the Individual AGI Tax, Corporate AGI Tax, Financial Institutions Tax, and Insurance Premiums Tax. Revenue collected from those taxes are deposited in the General Fund. The credit is nonrefundable, but unused credits may be carried forward for up to nine years. Unused credits may not be carried back.

The U.S. Bureau of Economic Analysis (BEA) provides national data on the amount of fixed private investments by industry type. This information can be used to establish the potential level of investments for which the credit could be claimed. The national data was apportioned to Indiana using the ratio of Indiana GDP to the U.S. GDP. The analysis focused primarily on the transportation and warehousing industrial sectors.

Measure (in millions)	Calendar Year						
	2005	2006	2007	2008	2009	2010	2011
HBI Credits Offered	$75.8	$26.4	$10.6	$3.6	$2.5	$7.1	$5.8
Total Indiana Private Nonresidential Fixed Investment in Structures*	6,900	8,150	10,130	11,020	8,390	7,150	7,730
Transportation and Warehouse: Indiana Private Nonresidential Fixed Investment in Structures*	454	534	585	585	407	343	354

*U.S. Bureau of Economic Analysis

The annual average level of private fixed investment in structures by Indiana businesses in the transportation and warehousing sector is estimated at $459 M per year between 2000 and 2011. Using the formula from the bill, the average growth during the three positive years was approximately $50.8 M per year. While there were nine years of decline in the aggregate data, individual firms could have increased levels of investments and qualified for an HBI tax credit for logistics improvements. The tax credit for investments in structures alone could potentially be $12.7 M a year. However, the bill caps the maximum amount of logistics-based HBI to $10 M per fiscal year.

The national investment data for nonresidential equipment is not detailed enough to separate creditable expenditures from total equipment investments.

The actual cost of this tax credit is contingent on the IEDC. While HBI was created to provide incentives for capital investments, it does not follow the trend for private nonresidential fixed investments in Indiana. The differing trends could be attributed to the HBI award process. HBI credits are provided after a taxpayer submits an application to the IEDC. The IEDC evaluates the application to determine whether the taxpayer is eligible for the credit and offers an amount of HBI credit based on their evaluation of investments that expand the Indiana workforce. HBI awarded for logistics investments do not have the same evaluation criteria, so it is likely that more logistics credits may be granted.

The bill places two limits on the amount of HBI that can be awarded by the IEDC and claimed by taxpayers. The IEDC can only award a total of $10 M in HBI credits per fiscal year towards qualifying logistics investments and a total of $50 M in nonlogistics investments per fiscal year. However, the caps also apply to the amount of credits that may be claimed per fiscal year. A situation may occur where several taxpayers were legitimately awarded HBI credits, but find themselves unable to claim them. For example, a taxpayer is granted a logistics credit of $5 M in 2014, and they can only claim $2 M for that taxable year. Next year, another taxpayer is granted a logistics credit of $9 M. When filing their returns, one of the taxpayers will not be allowed to claim the full value of their remaining credits because the total will exceed the $10 M per fiscal year limit. This will unlikely be an issue for credits awarded for nonlogistics investments. The average annual amount of credit claimed between 2005 and 2010 was approximately $10.4 M.

Explanation of Local Expenditures: (Revised) *Rural Entrepreneurship Area Development Incentives (READI)*: If an eligible county decides to apply to the OCRA to establish a READI area, they are required to submit an economic development plan to the OCRA. The county also has to approve the terms of loans granted to new businesses. The county may have to employ an expert consultant to assist in the development of these plans and to develop the criteria for approving loans. The county would have to apply sufficient funds and resources to accomplish this initiative.

Counties designated as READI areas must annually dedicate $250,000 in CEDIT revenue as a dollar-for-dollar match to the state income tax revenue captured by the READI.

<u>Explanation of Local Revenues:</u> (Revised) *Rural Entrepreneurship Area Development Incentives (READI)*: Each year, the amount of revenue deposited into a county READI fund would be the state income tax revenue collected from new employees and new businesses minus any EDGE credits awarded and the incremental income tax paid by existing businesses who expand their operations without receiving any state incentives. The distribution is capped at $250,000 per year. The actual revenue collected by a READI area depends on the success of the businesses and wages paid to employees within its boundaries.

(Revised) *Additional Information - READI Areas*: Under this bill, counties with a population less than 50,000 may apply to the OCRA to be selected as a READI area. As part of the approval process the county has to submit a written plan for supporting entrepreneurship and the establishment of new businesses in the area, and the county must confirm they will match state funds dollar-for-dollar with county CEDIT revenue. If selected by the OCRA, this designation is effective until the OCRA rescinds the designation, the county fiscal body specifies an earlier date, or January 1, 2024. While the bill limits the number of participating counties to 30, there are 57 counties that currently impose a CEDIT that also meet the population requirement.

Each year the county READI fund will receive a distribution from the state. Money deposited in the fund may only be used for a combination of the following:

- Transfer money to a revolving fund.
- Transfer money to a regional or local venture capital fund established under current law.
- Business incubator and accelerator development and operation.
- Small business support services.
- Assisting in the development of high speed Internet service within the county.

The county fiscal body would have to approve the terms of the loans. Interest payments on loans made from the revolving fund revert back to the fund. A county may not issue bonds using the fund as collateral. Two or more counties may enter into a written agreement to develop new businesses.

Once an area is terminated the remaining funds revert to the state General Fund.

<u>State Agencies Affected:</u> Department of State Revenue; Indiana Economic Development Corporation, Office of Community and Rural Affairs.

<u>Local Agencies Affected:</u> Counties with less than 50,000 in population who impose a CEDIT.

<u>Information Sources:</u> U.S. Bureau of Economic Analysis, *Table 5.4.5. Private Fixed Investment in Structures by Type, Table 5.5.5. Private Fixed Investment in Equipment and Software by Type*, *GDP by State: Indiana,* accessed on December 20, 2012, LSA Income Tax Database; LSA, *Indiana Income Tax Credit Study: Hoosier Business Investment Tax Credit,* September 2012; Global Insights Indiana County Level Forecast, June 2012; Bureau of Economic Analysis, *Regional Economic Profile: Indiana*; David Terrell, Lt. Governor, Executive Office, 232-5675.

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